



INDONESIA: ECONOMIC AND FINANCIAL HIGHLIGHTS MAY 2005

Summary:

- Indonesia's economic expansion continued at a robust pace in the first quarter of 2005, with GDP growth reaching 6.35% on a year-on-year (YoY) basis.
- Inflation fell to 7.4% in May 2005 after reaching a two-year high in March.
- Interest rates on Bank Indonesia (BI) benchmark one-month certificates (SBI) reached 7.95% on May 25, an increase of 25 basis points since April 20.
- BI launched a new short-term deposit instrument on April 26 to help it better control money market liquidity.
- On May 3, the State Secretariat issued a new Presidential Decree requiring improved vetting of managers for state-owned enterprises.
- The Government of Indonesia (GOI) replaced the President Directors of two large state-owned banks (Bank Mandiri and Bank Rakyat Indonesia) in May 2005.
- On May 17, the GOI sold Rp. 4.65 trillion (USD 489.1 million) of new domestic bonds in two series.
- In what is believed to be the largest foreign takeover in Indonesian history, Philip Morris International completed its USD 6.7 billion acquisition of Indonesia's third largest cigarette producer, Sampoerna, on May 18.
- Two GOI Ministries began restructuring negotiations with state-owned airline Merpati Nusantara.
- Finance Minister Jusuf Anwar and BI Governor Burhanuddin Abdullah attended the 38th annual Asian Development Bank (ADB) Conference in Istanbul, Turkey on May 4-6 at which ASEAN nations pledged closer financial cooperation.
- Indonesia's second largest telecom company, Indosat, plans to issue six-year bonds, and the infrastructure firm Bakrie and Brothers offered a rights issue to increase working capital.

Macroeconomic Update: Robust GDP Growth Continues

The Central Bureau of Statistics (BPS) announced on June 1 that Indonesia's YoY GDP growth reached 6.35% in first quarter of 2005. This is the second straight quarter where YoY GDP growth has exceeded 6%: Q4 2004 growth was 6.7%. The manufacturing, retail/hotel/restaurant, and transportation and communications sectors drove growth. On the expenditure side, gross fixed capital investment grew almost 15% YoY on the back of a 4.8% YoY expansion in Q2 2004.

Table 1: Indonesian Real GDP, Q1 2005 vs. Q1 2004

By Production Category	Percent change Q1 2005 vs. Q1 2004	Share of GDP
Manufacturing	7.1	28.1
Retail, hotel, restaurants	10.0	16.1
Agriculture	0.4	15.2
Services	5.1	10.0
Mining	3.6	9.3
Finance and leasing	6.8	8.2
Transportation and communication	12.8	6.1
Construction	8.6	6.0
Electricity, gas, water	6.7	1.0
Total (categories weighted)	6.35	100.0

By Expenditure Category	Percent change Q1 2005 vs. Q1 2004	Share of GDP
Household consumption	3.2	59.2
Government expenditure	-8.5	6.2
Investment	15.0	22.5
Exports	13.4	40.2
Imports	15.4	33.4
Total (categories weighted)	6.35	100.0

Source: Central Bureau of Statistics

On May 19, Finance Minister Jusuf Anwar reported to Parliament that the GOI had a Rp. 20.6 trillion (USD 2.2 billion) budget surplus in the first four months of 2005. The surplus is mainly due to expenditure delays in implementing the new combined budget process put in place this fiscal year. The rate of spending is expected to increase as the year progresses and line ministries become more familiar with the new budget process. The GOI's full-year budget deficit target is Rp 17.4 trillion (USD 1.8 billion).

Inflation

The BPS announced on June 1 that YoY Consumer Price Index (CPI) inflation slowed to 7.4% in May 2005 after peaking at 8.8% in March and 8.1% in April. The CPI rose 0.21% on a month-on-month (MoM) basis. National Development and Planning Minister Sri Mulyani Indrawati said Indonesia's 2005 inflation target of 7% is still within reach. On May 26, BI Senior Deputy Governor Miranda Goeltom told the Parliament that inflation could average 7 to 8% this year.

Table 2: Inflation Components, May 2005

Items	YoY inflation (%)
Staple foods	5.6
Processed foods and beverages, tobacco and cigarettes	6.7
Housing, utilities, power	7.2
Clothing	5.1
Health	3.8
Education, sports, recreation	10.4
Transportations, communications, financial services	12.3

Source: Central Bureau of Statistics

Interest Rates Rise

Bank Indonesia (BI) conducted the following auctions of its benchmark one-month certificates (SBI) in May:

Table 3: May SBI Auctions

Date	Interest Rate	Amount IDR (trillion)	Amount USD (billion)
May 4	7.81	53.6	5.6
May 10	7.87	4.9	0.4
May 18	7.90	36.9	3.9
May 25	7.95	3.0	0.3

Source: Bank Indonesia

In a May 16 Parliamentary hearing, BI Governor Burhanuddin Abdullah stated, “The Central Bank will keep increasing the SBI rate for the next three months to remain responsive to market conditions.” He also stated that BI will continue tight monetary policy to absorb excess liquidity, and that interest rates will continue to rise through the end of year. Analysts believe they could reach 8-9%.

New Short-Term Monetary Policy Instruments

On April 26, BI introduced a new deposit instrument designed to absorb short-term money market liquidity and deter foreign exchange speculation. The “Fine Tuning Contraction” (FTK) instrument offers maturities ranging from 1-14 days and complements BI’s other short-term instruments: a 7-day Fasilitas Bank Indonesia (FASBI) deposit facility (BI phased out an overnight FASBI window in January 2005); and one-month and three-month SBIs. On May 2 and 10, BI absorbed Rp. 1.6 trillion (USD 167 million) in deposits for FTK transactions at interest rates ranging from 5.75% for four-day deposits to 3.6% for two and three-day deposits. Several foreign exchanges dealers admitted that the new FTK instrument helped strengthen the rupiah, but only temporarily. They noted that although FTK rates are below the average quoted rate of 5–6% for two-day rupiah deposits in the interbank money market, the FTK instrument may be an attractive alternative to banks restricted from using the interbank market because of self-imposed lending or risk limits.

Presidential Decree on Management of State-Owned Enterprises

On May 3, the President issued Presidential Decree (Inpres) No. 8/2005 on the appointment of boards for state-owned enterprises (SOEs). The new decree regulates the selection process of SOE executives based on merit, skill, professionalism, and integrity, as well as transparency and accountability of the process. The decree establishes an assessment team for SOE managers consisting of the President, Vice President, Minister of State Administration, State Minister for SOEs, Cabinet Secretary, Chief of National Intelligence Agency (BIN), and relevant technical ministers.

New Management at State-Owned Banks

In the midst of an ongoing corruption scandal over alleged improper lending practices, on May 16, shareholders of state-owned Bank Mandiri appointed Agus Martowardojo as the bank's new President Director, replacing Eddie Neloe. (The GOI owns majority shares of Bank Mandiri, BRI, and BNI and controls shareholders meetings at each bank.) Martowardojo previously served as President Director of Bank Permata. Two days later, the Attorney General's Office arrested Neloe, former Vice President Director I Wayan Pugeg, and former Corporate Banking Director Shaleh Tasripan on corruption charges.

Mandiri shareholders also decided on a dividend at 50% of net profits, or Rp. 2.63 trillion (USD 276.7 million). At a May 18 press conference, Martowardojo promised a comprehensive evaluation of Mandiri with the aim of improving governance, accountability, and transparency. On May 30, the bank's 1Q05 financial statements showed a decline in net profits of 70.2% (YoY) to Rp. 519 billion (USD 54.8 million). According to the new managers, the decline is largely due to BI's new, stricter regulations on the quality of earning assets. Mandiri's net non-performing loans (NPLs) are 10.3%, far higher than BI's minimum requirement of 5%.

On May 17, Bank Rakyat Indonesia (BRI) shareholders named Sofyan Basri as the bank's new President Director, replacing Rudjito, who became President Commissioner. Basri was previously the President Director of Bank Bukopin. BRI shareholders also voted for a dividend of 50% of net profit and a maximum write-off of NPLs of Rp. 733 billion (USD 77.1 million). The fourth largest lender by assets, BRI reported a 1Q05 net profit of Rp 1.15 trillion (USD 121 million), up 4.87% from a year earlier. Interest income grew 5.35% to Rp. 4.0 trillion (USD 420.8 million) from Rp 3.8 trillion (USD 399.8 million) and its loan-to-deposit ratio increased to 76.5% as of March 2005, up from 66% the previous year. NPLs dropped to 4.6% of total loans from 6.3 earlier this year. In response to rumors of a probe into irregular lending to the agribusiness Domba Mas Group (total loans of Rp. 1.1 trillion or USD 115.7 million with Rp. 680 billion or USD 71.6 million outstanding), BRI management stated that the loans are performing and classified as current. BRI is 59.5% owned by the GOI.

At a May 19 shareholders meeting, Gatot Suwondo replaced Arwin Rasyid as Vice President Director of Bank Negara Indonesia (BNI). Other members of BNI's board of directors maintained their positions. Shareholder also voted for a dividend of 50% net profit.

New BI Deputy Governor, JSX Head Reappointed

On May 10, Parliament's Commission XI appointed the highly regarded Siti Chalimah Fadjriah as a new Deputy Governor at Bank Indonesia with responsibility for bank supervision, subject to a "fit and proper" test. All 56 members of Commission XI supported the appointment. The commission called on the new deputy to raise the standard of bank practices in the light of recent governance and fraud problems in the banking sector.

On May 11, current President Director of the Jakarta Stock Exchange (JSX) Erry Firmansyah was re-appointed by JSX shareholders. Erry announced his intention to revise upwards JSX's target for daily transactions. Its current daily transactions have reached Rp. 2.1 trillion (USD 220.9 million), well above an earlier target of Rp. 750 billion (USD 78.9 million).

GOI Issues Bonds

On May 17, the GOI raised Rp 4.65 trillion (USD 489.1 million) through the issuance of two series of rupiah bonds, FR0029 (2 year maturity with yield of 9.71%) and FR0030 (11 year maturity with yield of 11.29%). Analysts viewed the GOI's auction of two different maturities as a test of market sentiment. So far in 2005, the GOI has issued Rp. 24 trillion (USD 2.5 billion) of a planned Rp. 43 trillion (USD 4.5 billion) in bonds to finance the 2005 budget deficit. The GOI also has budgeted Rp. 1.2 trillion (USD 126.2 million) to buy back government debt this year. As of May 16, the government has paid back maturing debt of Rp 17 trillion (USD 1.8 billion), including:

- Rp. 400 billion for FR0003 (FR = Fixed Rate)
- Rp. 7.5 trillion for FR0008
- Rp. 5.8 trillion for FR0009
- Rp. 452 billion for hedge bonds

(Hedge bonds are non-tradable bonds issued to banks to hedge their Net Open Positions. Hedge bond maturities are between 3 months and 3 years, with a coupon at the 3-month SIBOR rate plus 2%. The coupon is payable quarterly and linked to IDR/USD exchange rate. The GOI no longer issues hedge bonds.)

Table 4: Government Bonds: Ownership, Yields, and Maturities

	December 2004 (Rp trillion)	March 2005 (Rp trillion)
Banks	287.6	287.0
Others	111.7	121.8
Total	399.3	408.7

Type	Average Yield (%)	Maturity (Years)	Percentage
Fixed rate	12.60	5.2	46.3
Variable rate	7.38	8.7	53.5
Hedge Bonds	4.97	0.1	0.2
Total Outstanding	9.79	7.1	100.0

Source: Ministry of Finance

PMI Completes Acquisition of Sampoerna

Philip Morris International acquired 57% of Indonesian cigarette maker HM Sampoerna's shares through a April 17-May 18 tender offer after purchasing 40% of the company's shares in March. The transaction is believed to be the largest-ever foreign acquisition of an Indonesian company. Sampoerna chairman Matteo Pellegrini stated, "our first target will be to overtake Gudang Garam as the number one cigarette company in Indonesia." The merger would increase Sampoerna's market share in Indonesia to about 25%, making the combined tobacco company the second largest, overtaking Djarum. Sampoerna is one of the largest companies in the Jakarta Stock Exchange's (JSX) composite index of blue chip stocks (LQ45). Indonesia is the world's fifth largest cigarette market.

GOI Props Up Ailing Domestic Airlines

On May 2, the Ministries of Transportation and State-Owned Enterprises (SOEs) began restructuring talks with ailing, state-owned Merpati Nusantara Airlines, a domestic carrier. Minister for Transportation Hatta Rajasa stated that the GOI would provide an immediate capital injection, but the Ministry of Finance has not confirmed this statement. Merpati currently holds Rp. 1.3 trillion (USD 136.8 million) in debt, Rp. 230 billion (USD 24.2 million) in the form of loans from Bank Mandiri. Its total capital is only Rp. 800 billion (USD 84.2 million). Estimated capital required for the restructuring is Rp. 600 billion (USD 63.1 million). President Susilo Bambang Yudhoyono asked Coordinating Minister for the Economy Aburizal Bakrie, Finance Minister Yusuf Anwar, State Minister for SOEs Sugiharto, and Transportation Minister Hatta Rajasa to resolve Merpati's problems.

GOI, BI Participate in ADB Conference

On May 4–6, the GOI and BI participated in the 38th annual Asian Development Bank (ADB) Conference in Istanbul, Turkey. The meeting resulted in a call for closer

economic cooperation between Asian nations. BI Governor Burhanuddin Abdullah said more private sector participation in infrastructure financing is needed in addition to support from banks, pension funds, and mutual funds. “ASEAN plus 3” nations agreed to strengthen financial cooperation. The ADB announced its support for efforts to improve regional economic coordination and integration via infrastructure spending assistance, financial cooperation, and trade and investment. The ADB also announced it would form an economic surveillance unit to assist countries in responding to crises in their early stages.

Finance ministers of “ASEAN plus 3” nations agreed to facilitate the Chiang Mai Initiative (CMI) and also further develop Asian Bond Market Initiatives. These include commitments to:

- integrate and increase surveillance of the economies of ASEAN plus 3;
- implement a swap mechanism and a clear, collective decision making process for Bilateral Swap Agreement (BSA) multilateralization;
- double the increase number of swap transactions by 100%; (Total BSA is currently USD 39.5 billion, with 16 BSAs. Indonesia has 3 BSAs; USD 3 billion with Japan, USD 1 billion with Korea and USD 1 billion with China.)
- Increase the proportion of swaps which could be drawn outside IMF program, from 10 to 20%.

Corporate Finance Update

On May 4, Indonesia’s second largest telecommunications company Indosat, majority owned by Singapore Technologies, announced its plan to issue Rp. 1.2 trillion (USD 126.2 million) of six-year bonds. Indosat plans to list the bonds on the Surabaya Stock Exchange (SSX) on June 16. Domestic rating agency Pefindo rated the proposed bonds AA plus. Estimated yields range between 11.8 – 12.3%. Indosat needs USD 900 million of working capital in 2005, and USD 666 million for 2006. According to the company’s 2004 audit report, its revenue was Rp. 10.5 trillion (USD 1.1 billion), an increase of 28% compared to the previous year. Its cellular telephone business contributes approximately 70% of the revenue. The company is also reportedly planning to issue dollar-denominated bonds.

Foreign-owned water company PAM Lyonnaise Jaya announced on May 18 it will issue Rp. 700 billion (USD 73.6 million) of bonds in June with maturities ranging from two to seven years. It has named Trimegah Securities, Mandiri Sekuritas, and Deutsche Securities as underwriters. Pefindo has rated the bonds single A minus with a stable outlook. The company said it will use some proceeds from the bond issuance for debt repayment, and the remainder for capital expenditure and investment. Two other local companies, Swadharma Indotama Finance and Ricky Putra Globalindo, also announced bond issuances scheduled for June.

In late April 2005, the Development Bank of Singapore (DBS) purchased USD 150 million of Bank Internasional Indonesia (BII) subordinated debt. The sub-debt offered 7.5% yield, with a 10-year maturity. BII will use the funds to purchase a 67% share of

finance company WOM Finance. BI has so far only approved BII's acquisition of 43% of WOM Finance under legal lending limit (LLL) regulations, but BII seeks majority shareholder status. BII President Director Henry Ho stated that the company brought in the International Finance Corp (IFC) and an unnamed investor to acquire the remaining shares.

On May 10, the Indonesian firm Bakrie and Brothers (owned by the family of Coordinating Minister for the Economic Affairs Aburizal Bakrie) offered a rights issue of Rp 1.9 trillion (USD 199.9 million). It permits every holder of 62 shares to buy 25 new shares at Rp. 100 per share. The company will use the proceeds to expand its business including Rp. 200 billion (USD 21 million) for working capital. According to President Director Bobby Gafur Umar, the company is expanding infrastructure for its oil and gas sector development. The company will also use Rp. 264 billion (USD 27.8 million) to refinance its short-term debt from Suisse Chartered Investment Ltd, used to acquire Bakrie Sumatra Plantations. Rp. 743 billion (USD 78.2 million) will be used to repay the debt of its subsidiary Bakrie Pipe.

Selected Economic, Monetary & Financial Statistics

	Feb 05	Mar 05	Apr 05	May 05
CPI Inflation (YoY)	7.15	8.81	8.12	7.40
CPI Inflation (MoM)	1.26	1.91	0.34	0.21
Rp/USD Exchange rate ¹	9,265	9,510	9,570	9,480
30-day SBI Interest Rate ²	7.42	7.44	7.70	7.90
Foreign reserves ³	36.54	36.03	36.43	34.61
JSX Composite Index	1073.8	1080.2	1029.6	
JSX Trans Volume ⁴	2.02	2.98	1.40	
Exports (USD billion)	6.38	7.25	6.75	
% Change (YoY)	30.13	42.95	31.12	
Import (USD billion)	3.98	4.98	5.02	
% Change (YoY)	18.69	59.11	33.85	
Trade Balance ⁵	2.40	2.27	1.73	

Source: Bank Indonesia, BPS

(1) Rp/USD, end of period

(2) End of period

(3) USD billions, end of period

(4) Jakarta Stock Exchange average daily transaction volume, in billions of shares

(5) USD billions

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